198867

AMERICAN FARM BUREAU FEDERATION®

225 TOUHY AVENUE • PARK RIDGE • ILLINOIS • 60068 • (847) 685-8600 • FAX (847) 685-8896
600 MARYLAND AVENUE S.W. • SUITE 800 • WASHINGTON, D.C. • 20024 • (202) 484-3600 • FAX (202) 484-3604
Internet: http://www.fb.com/

ENTERED
Office of the Secretary
JUN 05 2000
Part of
Public Record

RECEIVED
JUN 5 2000
MAIL
MANAGEMENT
STB

June 5, 2000

Via Courier

Office of the Secretary
Case Control Unit
ATTN: STB Ex Part No. 582 (Sub. 1)
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Dear Sir or Madam:

Please find enclosed an original and 25 copies of the Reply Comments of the American Farm Bureau Federation in reference to the above matter.

Sincerely,

Richard W. Newpher
Executive Director
Washington Office

pc. All Parties of Record

Before the Surface Transportation Board

RECEIVED
JUN 5 2000
MAIL MANAGEMENT
STB

STB Ex Parte 582 (Sub. No. 1)

Major Rail Consolidation Procedures

Reply Comments of the American Farm Bureau Federation

Now comes the American Farm Bureau Federation (AFBF) and respectfully submits its comments in response to comments of other filers to the Surface Transportation Board, pursuant to the Board's order of March 31, 2000, as follows:

The American Farm Bureau Federation is a national association of farmers and ranchers representing Farm Bureau families in every state and Puerto Rico. Farm Bureau represents these farmer-members in matters concerning regulatory concerns and the ongoing financial viability of the farming and ranching operations. In this regard, Farm Bureau has requested and received leave from the Board to comment on the Board's undertaking to evaluate and perhaps rewrite its criteria for evaluating railroad mergers.

Under current merger rules, the STB places a very high priority on railroads' financial health, and must give great weight to whether a proposed merger will permit the merged railroads to eliminate redundant capacity and undertake other streamlining measures to improve efficiency. The concerns and welfare of shippers seem to have been given lower priority; the STB appears to assume that a financially healthier railroad will automatically give better service to shippers.

The STB seems to have very little concern about the concentration of market power, or the possible ability of railroads to engage in anti-competitive behavior as recent mergers begin to create a North American railroad oligopoly or duopoly.

In general, future policy concerning mergers must observe several basic principles to ensure that the public interest is preserved, and that the interests of railroad customers are not damaged:

- Stronger action must be taken to hold merging railroads accountable for their promises of improved service and more efficient operations.
- The severe service problems that have resulted from past railroad mergers must be prevented and/or mitigated through effective remedies, including performance guarantees compensation and access to other railroads.
- Current regulatory policies, including the bottleneck decision, the "one-lump" theory, and the "2-to-1" rule, have failed to prevent reduced competition among major railroads, which now enjoy unprecedented market power.
- The regulatory policies of the past, which the STB has recognized as inadequate and which even many railroads are now recognizing as flawed, should be replaced by new policies aimed at promoting competition.
- Access remedies such as trackage rights and switching on fair and economic terms should be more readily available, whether or not there are future mergers.
- Contractual and operational barriers to competition from smaller railroads should be eliminated or reduced, whether or not there are future mergers.
- Gateways for all major routings should remain open on reasonable terms.

- Adverse impacts of rail consolidations on the safety of rail operations and on the interests of rail labor should be mitigated.
- Cross-border mergers should not interfere with effective regulation and the enhancement of competition; and
- Railroad mergers can no longer be considered in isolation.

The need for improved and enhanced competition along these lines is so strong and immediate that the STB should use the full extent of its authority to revise its policies consistent with these principles. The Board's efforts in *Ex Parte No. 582 (Sub-No. 1)* should include, but not be limited to, all of the recommendations in the proceeding that would:

1. Increase competition among railroads;
2. Improve service and safety; and
3. Address any problems or flaws—present or future—which result directly or indirectly from rail mergers.

Recognizing that the Board may not have the necessary authority to fully achieve comprehensive policy reform consistent with all of the above-listed principles, the rail customer community will continue to press for congressional action that would provide the necessary legislative direction to achieve these principles.

What follows is a series of recommended changes we recommend with regard to how the Board should adapt its merger rules to the rapidly consolidating rail industry

Competition

Though the Class I railroads believe it is inappropriate for the Board to even address competitive issues in its consideration of merger rules, competition must be addressed in this merger rules proceeding because of the profound negative impact past consolidation has had on competition and the negative impact future consolidation could have. To ignore competitive issues is to ignore one of the major features of any merger.

Merger rules must:

- **Preserve what competition remains**

Since the passage of the Staggers Act in 1980, the number of Class I railroads serving the United States has declined from 42 to five. By definition, fewer players in any marketplace will mean less competition for customers. To be sure, some of the railroads that failed or were absorbed were too financially weak to provide high quality service to their customers, and a certain amount of consolidation was clearly necessary to ensure the future health of the industry. Arguably, in recent years consolidation has been allowed to proceed to the extent that most rail customers, particularly those located in rural areas, no longer have access to competitive rail service. In some cases, specific changes in rail policy may be able to provide a modicum of competition among the remaining Class I railroads. However, it will be necessary for STB to evaluate recent mergers that have had the effect of reducing competitive service opportunities, and institute oversight proceedings where needed.

We recommend that STB include more specific competitive conditions in future mergers, and consider imposing these where appropriate with mergers that have already occurred. Such conditions could require a railroad proposing merger to offer point-to-point rate quotes, even over origin or destination bottlenecks. Competitor railroads should be offered access over bottlenecks, with reasonable compensation for the incumbent railroad, and with an understanding that the competitor railroad's operations do not unduly interfere with the incumbent railroad's operations. Another potential condition could be to require a merged railroad to interchange freight with a competitor railroad, as the customer wishes, so long as provision of this interchange does not unduly interfere with the incumbent railroad's operations.

- **Encourage any new competition wherever possible**

The STB should examine changes in policy that will encourage new competition wherever possible. The United States is currently served by only five Class I railroads (seven if Canada and its railroads are included). This creates situations where shippers in vast regions of the United States are captive to a single rail service provider. STB policy should encourage Class I railroad companies to seek competition with one another, and to be more competitive with other modes, like trucks and waterways. This can only be accomplished if railroad companies are encouraged to recognize that their interest lies in serving more customers at lower unit cost, improving their profitability. Now, railroads seem intent on reducing capacity and attempting to steal freight from one another, charging captive shippers to make up for loss-lead discounts they offer to gain rail competitors' traffic.

- **Carefully evaluate or refrain from future competition-reducing mergers**

The 1995 merger that created the Union Pacific Railway clearly reduced competitive service opportunities for agricultural shippers. Because of these concerns, AFBF opposed that merger, and continues to be concerned about the implications of mergers for competitive service opportunities for shippers. AFBF also expressed concerns about the merger that created the Burlington Northern Santa Fe.

Recently, the Burlington Northern Santa Fe railroad has proposed to merge with the Canadian National railroad. Advocates of that merger have contended that shippers should have little fear of this merger because it is largely an end-to-end merger, rather than a parallel merger that will lend itself to eliminating competitive service opportunities. However, there will be instances, particularly in Mississippi River corridor areas, where some shippers will lose competitive rail service due to this proposed merger.

Past mergers have been evaluated largely on the basis of whether the merger improved the financial health of the railroad company involved. We believe it is clear that if the seven Class I railroads currently serving North America cannot generate sufficient traffic and revenue in vast areas that amount to rail transportation franchises to be sufficiently profitable, the problem lies less with their prices or excess and redundant capacity than with poor management and customer service.

- **Enhance the competitive position of short-line and regional railroads vis-à-vis Class Is; discourage future "paper" and "steel" barriers and try to remove those that exist; improve infrastructure quality and address capital challenges for short-lines and regional railroads**

Regional railroads like Tex-Mex and Montana Rail Link have the potential to provide limited competitive service for shippers, in the sense that they may be able to serve a limited number of origin-destination pairs for some shippers. In many instances, they are not permitted to do so due to contractual obligations undertaken when they purchased infrastructure from a Class I. Some regional railroads are required to interchange cars only with the Class I from whom they purchased or leased their tracks, or from whom they obtained their trackage rights. In other instances, Class I railroads actually remove existing track or erect barriers to physically prevent movement of cars by a regional railroad to a competitor's tracks.

This sort of "steel" and "paper" barriers are a reflection of the market power possessed by Class I railroads, where they have gained control of vast infrastructure resources through mergers of dubious wisdom. The Class I's then use that market power to prevent any competition from regional or short-line railroads. A recent article for the Journal of Transportation Law, Logistics, and Policy, asserts that such barriers are a *per se* violation of Section I of the Sherman Anti-Trust Act, which prohibits "tying" arrangements between businesses in the transfer of products and assets. In *Northern Pacific Railroad Co. v. United States*, the U.S. Supreme Court found that Northern Pacific's practice of requiring purchasers of Northern Pacific-owned lands along its lines to ship the produce of those lands on Northern Pacific's railroad constituted a tying arrangement prohibited by the Sherman Act. How is such a "tying" arrangement significantly different in effect from "paper" and "steel" barriers demanded by Class I railroads in exchange for the sale or lease of track or trackage rights?

As a matter of public policy, the Board should use its regulatory power to prevent Class I railroads from imposing "steel" and "paper" barriers that hamper regional and short-line railroads from providing competitive service.

- **Permit shippers to demand competition through competitive service reforms such as allowing shippers to obtain "bottleneck" rates and access to competing railroad service providers in terminal areas**

The Board has failed to impose any obligation on railroad companies to provide access to competitors, leaving many shippers captive to a single rail service provider. This condition of captivity could be easily remedied be simply requiring the incumbent rail service provider to provide a rate for service to the destination preferred by the shipper rather than that preferred by the railroad, even if the destination is an interchange point with a competitor, or the destination is served by a competitor.

The Board should either act to require railroad companies to facilitate interchange of freight at the direction and preference of shippers so long as such interchange does not unduly hamper the operation of the incumbent railroad, or assist shippers to formulate appropriate legislation to accomplish this.

- **Encourage origin <u>and</u> destination competition where possible**

Because the Board has permitted massive consolidation in the rail industry over the last twenty years, it has become necessary for shippers to demand "bottleneck" rates and terminal areas access, even though meaningful competition would be preferable. Future Board policy toward consolidation should encourage origin and destination competition wherever possible. The lack of competition at both ends of a movement effectively confers a monopoly on the carrier that is successful at obtaining a monopoly at either end of the movement.

<u>Merger Analysis</u>

It is plain that when the Board completes its reconsideration of its merger rules, it will be faced with a barrage of proposed mergers, both the already-proposed BNSF-CN merger and a series of defensive mergers by its competitors. The Board's analysis of future merger proposals will be very important in minimizing the anti-competitive effects of any future mergers. The Board should analyze any future mergers using the following criteria:

- **The effect the merger will have on shipping rates paid by customers/shippers due to reduced competition**

It is clear that past mergers have increased the rates paid by captive shippers. This is particularly true of captive agricultural shippers. Grain producers in western states pay very high rates to ship their grain. Over the years, the Interstate Commerce Commission--and the Surface Transportation Board that succeeded it--determined with the powers granted by the Staggers Act that a shipping rate of 160 percent of a railroad's variable costs (labor, transportation, fuel, etc.) is full return of the railroad's cost of capital. Further, the Staggers Act determined that railroad rates greater than 180 percent of variable cost are excessive.

Today, shipping rates for wheat from captive shippers in Montana to the Pacific Northwest average 225 percent to 250 percent of variable cost; for Idaho wheat producers, rates average 205 percent to 275 percent; in Nebraska, where wheat shippers enjoy at least a modicum of competition, rates average between 195 percent and 235 percent of variable cost. These figures were offered by shippers as evidence in litigation surrounding the *McCarty Farms* case and were not disputed by the railroads.

In *Ex Parte 575*, the North Dakota Public Service Commission, the North Dakota Wheat Commission and the North Dakota Grain Dealers Association submitted shipping cost figures to the STB in March 1998 regarding shipping rates from North Dakota to the Pacific Northwest. According to that submission, shipping rates averaged 229 percent to 257 percent of variable cost, using rate figures from the fourth quarter of 1995.

But rather than concentrate on economic theory like percentages of variable cost, one can look at prices to move rail cars from certain locations to major grain ports like Portland to learn the true cost of the lack of rail competition for farmers. Burlington Northern charges $3,792 to move a hopper car in a 52-car train carrying 3,260 bushels of grain from Plentywood, Montana 1207 miles to the Portland, Oregon. That is about $1.13 per bushel for rail transportation cost.

From Alliance, Nebraska to Portland, Oregon (1473 miles) Burlington Northern charges $3,325, or about $.99 per bushel. Thus, we have the odd situation that Nebraska farmers shipping from Alliance pay less per bushel to move their grain farther than their Montana counterparts shipping from Plentywood. Why should Montana farmers pay $.24 per bushel more to ship their grain more than 200 fewer miles than Nebraska farmers do? In this case, Nebraska farmers benefit to a limited degree from competition between railroads. Farm Bureau believes that all farmers, including those in Montana, should enjoy the benefit of competition, and Nebraska farmers should enjoy even greater benefits of competition than they enjoy now. It is important to remember that every penny in shipping cost that results from a lack of meaningful competition is borne by farmers in the form of lower grain prices at the elevators where they sell their grain

- **The likelihood that the merger will result in significantly increased market power for the merged railroad**

Prior to the absorption of Conrail by CSX Transportation and Norfolk Southern in 1999, rail shippers in many regions of the eastern United States could choose between as many as three

Class I rail service providers. The carve-up of Conrail has both removed one competitor and made the administration of the resulting eastern rail duopoly more efficient. The presence of only two competitors in a region facilitates uncoordinated collusion as one competitor simply observes and emulates the behavior of the other.

- **The likelihood that the merger will increase the potential for anticompetitive or predatory pricing practices**

This is, of course, related to the market power concern expressed above. Any merger that increases the potential for such behavior should not be allowed to occur. Even in periods of very low grain prices when very little grain is moving, railroads have demonstrated a disturbing tendency to raise their freight rates in what would seem to be a counter-intuitive response to market forces. From Nebraska, Colorado and Kansas, both Burlington Northern and Union Pacific raised their per-car shipping rates seven times between October 1, 1997, and October 1, 1998, and decreased service options for agricultural shippers by increasing the minimum required shipments. If the Board must allow such a merger to occur, the Board must engage in more effective oversight than it has exercised in the past, particularly with regard to the merger in which Union Pacific absorbed Southern Pacific.

- **The effect of the merger will on shippers on a regional, as well as a national basis: Will the merger remove a competitor from the marketplace? How does the Board propose to address that problem?**

The merger of the Canadian National and the former Illinois Central effectively removed a conduit for corn shippers to move corn to barge terminals along the Mississippi River. Illinois Central made such movements a core business prior to the merger, but CN seems to have little interest in such movements, according to anecdotal reports from the region. This forces farmers and other agricultural shippers to rely primarily on trucks to ship corn to barge terminals. Given national concerns about highway safety, highway congestion, and lagging infrastructure investment in rural areas, how is the public interest served by the Board permitting such a merger? Could the Board have imposed a condition on that merger that would have required the successor railroad to maintain such service to prevent the burden of shipping this farm produce from being shifted to overworked and underfunded highways?

Customer Service

The Board should make quality customer service a high priority for all its considerations of relationships between railroads, shippers, and regional and shortline railroads. Railroads today carry about the same amount of freight they carried in the 1950s, despite the fact that the U.S. Gross Domestic Product has increased several fold in the last half-century. According to the U.S. Department of Agriculture, more than half of all agricultural production moves to its final point of use or export on trucks. In the absence of poor customer service and exorbitant rates, it is clear that a much higher share of grains would be shipped by rail because rail should be a far more efficient and environmentally friendly mode than trucks.

Also, the major mergers of the last 20 years have clearly been aimed at reducing capacity to reduce costs, rather than removing redundant capacity or deploying improved technology to improve efficiency and productivity. Class I railroads must be forced to choose between serving rural customers themselves or allowing short-line and regional railroads to serve rural customers in the absence of excessive "paper" and "steel" barriers.

- **Shipper impact should be a prime criteria to evaluate proposed mergers**

Shipper impact must be carefully considered in future mergers. Captive shippers remain captive because even with high rates and poor service, railroads remain the only economically viable means of shipping agricultural commodities and agricultural inputs to and from remote regions of the country. In considering past mergers, the Board seems to have treated the mere existence of highways and trucks, and of waterways and barges as *per se* evidence that intermodal competition for a railroad monopoly exists, despite the utter economic infeasibility of using these modes. The Board has also held that if an in-bound shipper can source a commodity at any location other than the preferred location, or if an outbound shipper can ship to any other location, that shipper has no viable complaint on the basis of lost competition. The Board should not permit the economic convenience of railroad companies to impose economic inconvenience on their customers.

- **"3-2" and "4-3" shipper competition loss should be treated as seriously as a "2-1" competition loss**

For a potentially captive shipper, any competition loss is a serious situation. The maximum possible number of competitors gives a customer the maximum number of options, both for who the carrier shall be and even whether the customer will be able to service different origin or destination points that might not be available when competition is lost.

- **Railroads should be held responsible for service failures, especially those caused by mergers; customers should be compensated for losses resulting from service failures**

Many businesses suffered serious economic losses during the Union Pacific Houston service meltdown. These businesses have not been made whole, and Union Pacific probably doesn't have the financial wherewithal to make them whole. This is all the more reason why mergers that could have massive negative consequences of Union Pacific's absorption of Southern Pacific must be carefully considered.

Prior to the massive consolidation of the last 20 years, railroads collectively operated as a near-public monopoly, providing essential transportation services. As consolidation has radically reduced the number of competitors in rail transportation marketplace, the remaining players have accumulated significant market power *vis a vis* their customers. For many businesses, railroads now enjoy the power to make or break their customers. At a minimum, railroads should somehow be held financially responsible for the economic losses incurred by their customers when the railroad fails to provide adequate service.

The Board should require future merger parties to submit Service Implementation Plans, outlining how they intend to maintain service during the merger transition. While most of the Class I railroads participating in this proceeding indicated some level of support for this concept, they are not interested in any potential penalty for failure to meet the conditions of the plan. However, a plan with no penalty for non-compliance is nothing more that an empty promise. AFBF has already asked STB, in our initial filing in this proceeding, to be more skeptical of merger parties' claims.

- **Regional rate discrimination among railroad customers should be eliminated; rates should be based solely on weight and distance**

The STB's rate appeal process is an absurdly complex artifice that only a small handful of the wealthiest shippers can afford to use. Many of the rest are left to suffer paying rates that can exceed 300 percent of variable cost when the STB has determined that 160 percent of variable cost constitutes a sufficient return on the railroad's investment. Even in a recent instance where a large and wealthy shipper (FMC Corporation) managed to pursue and win a case against a railroad, the relief they was minor at best.

Ideally, common carrier rates for shippers should be based solely on the amount of effort that is required for the railroad to service a customer; on the weight to be shipped and the distance it is to be shipped. The Board should consider capping shipping rates for captive customers at 180 percent of variable, or providing a radically simplified rate appeal process in instances where rates exceed 180 percent of variable cost.

- **Unanticipated post-merger problems should be examined and corrected**

The Board utterly failed in its obligation to shippers to impose corrective measures in the wake of the Union Pacific service meltdown. Gridlock was allowed to persist around Houston for months while shippers suffered serious economic losses. AFBF supported the Houston Consensus plan the Board considered in Finance Docket No. 32760 (Sub. No. 27)(1). The Houston Consensus plan had real potential to alleviate congestion in this key hub area where substantial amounts of grain are trans-shipped. Unfortunately, the Board rejected this potential remedy and elected to do nothing. Any future mergers must be accompanied by vigorous post-merger oversight to prevent these kinds of problems from occurring and to speed their correction.

Railroad Financial Health and Management Issues

- **A viable industry is key to the future success of American agriculture**

In many regions of the country, railroads are clearly the most efficient mode available to ship agricultural products. Better management could make this an even more competitive mode that attracts more traffic from competing modes.

- **Mergers are not the only way to reduce cost**

In recent years, railroads and the Board seem to have assumed that mergers and elimination of redundant capacity is the only means of reducing cost. Unfortunately, eliminating redundant capacity in both track and rolling stock hampers a railroad's ability to take extraordinary measures to resolve congestion issues and respond to extraordinary market conditions. For reasons that mystify farmers and agricultural shippers, railroads seem to have chronic capacity problems for meeting the need for adequate rolling stock and motive power to move farm produce during harvest seasons. Grain harvests have occurred at roughly the same time in the Great Plains regions for 150 years, and yet railroads mysteriously seem to lack the capacity to plan to serve this need.

Railroads also seem to be uninterested in deploying technology to improve efficiency and productivity. When hand-held Global Positioning System transceivers can be purchased from mail-order sporting goods catalogues for less than $200, there is absolutely no reason why a railroad company should be unable to tell a customer precisely where a shipment is and when it arrives.

- **Acquisition premiums and viability of merged railroad**

In the most recent rail mergers, railroad companies have taken on massive debt to aquire one another. This debt hampers a railroad's ability to undertake capital improvements to better serve customers. Why is the Board apparently uninterested in the implications of this massive debt for the future financial health of railroad companies? Why are railroads the only quasi-public utility industry permitted to assess costs of its acquisition premiums and service failures to its customers?

In summary, American farmers have serious concerns about the accumulation of inappropriate market power in the hands of a few railroad companies. They are concerned about the impact on their market position of this accumulation of market power by railroads. They are concerned that railroad companies' efforts to eliminate redundant capacity will leave them badly served or not served at all, while major railroad companies seem to want to prevent regional and short-line railroads from filling the gap. Farmers believe the only way railroad companies will improve their future prospects will be to improve customer service, take market share from competing modes, and improve their use of technology to improve productivity.

Certificate of Service

I hereby certify that this statement of the American Farm Bureau Federation has been duly served on all Parties of Record identified on the Ex Parte 582 (Sub. 1) service list via first class mail in the United States Postal Service this 5th day of June, 2000.

Richard W. Newpher
Richard W. Newpher
Executive Director
Washington Office